Supreme Court, U. S.
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IN THE

# Supreme Court of the United States

_____ Term, 1977

No. 76-1217

JOE TERRY POYNER, by and through his statutory guardian, Dorothy Poyner — PETITIONER

vs.

LEAR SIEGLER, INC. — RESPONDENT

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner, Joe Terry Poyner, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit, entered in the above-entitled case on October 14, 1976.

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## OPINIONS BELOW - JURISDICTION

The U. S. District Court for the Western District of Kentucky, Paducah Division, Hon. James F. Gordon, entered judgment in favor of the plaintiff-petitioner on May 8, 1975. The Sixth Circuit Court of Appeals decided and filed an Opinion, reversing, on October 14, 1976. By Order dated November 30, 1976 Rehearing was denied. The Opinion of the district court was not reported. The decision of the United States Court of Appeals for the Sixth Circuit is reported at 542 F.2d 955 (6th Cir., 1976). The text of the decision of each of the lower courts is included herein. There has been no request for any extension of time within which to petition for certiorari. 28 USCA §1254(1) confers upon the Supreme Court jurisdiction to review these decisions by writ of certiorari.

## QUESTIONS PRESENTED

I. DOES ERIE R. CO. V. TOMPKINS, 304 U.S. 64 (1938) REQUIRE A FEDERAL COURT TO APPLY FORTY YEAR OLD FORUM STATE CORPORATION CASE LAW, WITHOUT ANY ANALYSIS OF PUBLIC POLICY FACTORS, TO A GERMAN BUSINESS ENTITY WHICH IS NOT EVEN A TRUE CORPORATION?

II. IF A PARENT COMPANY EXERCISES ITS CONTROL OVER A WHOLLY-OWNED SUBSIDIARY TO ACCOMPLISH



A RESULT WHICH IS INEQUITABLE TO FORESEEABLE KENTUCKY CREDITORS, WOULD KENTUCKY COURTS HOLD THE PARENT CORPORATION ACCOUNTABLE TO THOSE KENTUCKY CLAIMANTS?

III. IS IT INEQUITABLE FOR A CALIFORNIA BASED PARENT OF A GERMAN SUBSIDIARY COMPANY TO INSTRUCT THAT SUBSIDIARY, A FIREARMS MANUFACTURING PLANT, NOT TO RESPOND TO ANY PRODUCTS LIABILITY CLAIMS IN THE UNITED STATES WHERE MANY OF ITS PISTOLS ARE SHIPPED?

## STATUTES INVOLVED

The decision of the Sixth Circuit Court of Appeals was premised upon an analysis of case law re "piercing the corporate veil". While shareholder liability for the torts of a corporation is a doctrine developed largely by the courts applying equitable principles, such shareholder liability also is treated by statute in Kentucky. While there has been minimal development in this area in Kentucky case law in the last forty years, there has been a liberalizing trend apparent in statutory changes. To demonstrate that principle, we quote the following Kentucky statutes dealing with shareholder liability, appearing in chronological order:

(a) Carroll's Statutes, §547:

"§547. Stockholders; liability of; action to enforce; limitation. -- The stockholders of each corporation shall be liable to creditors for the full amount of the unpaid part of stock subscribed for by them, and no stockholder shall be liable because of being a stockholder, for any sum more than to the amount of the unpaid part of stock held by such stockholder of any company, except stockholder in guaranty companies, investment companies and insurance companies shall be liable equally and ratably, and not one for the other, for all contracts and liabilities of such corporation to the extent of the amount of their stock at par value, in addition to the amount of such stock; but persons holding stock as fiduciaries shall not be personally liable as stockholders, but the estates in their hands shall be liable, in the same manner and to the same extent as the property of other stockholders, and no transfer of stock shall operate as a release of any such liability existing at the time of such transfer; provided, the action to enforce such liability shall be commenced within two years from the time of transfer." (Effective May 16, 1936)(Carroll's Kentucky Revised Statutes, Baldwin's 1936 Revision, p. 296)



(b) KRS §271.180(1):

"271.180 [547] Stockholders' liability; effect of transfer.

"(1) Each stockholder of a corporation shall be liable to creditors for the full amount of the unpaid part of stock subscribed for by him. Except as provided in KRS 287.360 and subsection (2) of this section, no stockholder shall be liable, because of being a stockholder, for any greater sum." (KRS §287.360 provides double liability for holders of bank stock) (Baldwin's Kentucky Revised Statutes, 1943 Revision, Chapter 271, pp. 9-10)

(c) KRS 271.215 (1), (2) and (4)

"271.215 Liability of incorporators, subscribers, shareholders, directors and officers.

"(1) A subscriber to or holder of shares of a corporation formed under this chapter shall be under no liability to the corporation with respect to such shares other than the obligation of complying with the terms of subscription therefor; but one who became a shareholder in good faith and without knowledge or notice that the shares be acquired had not been fully paid for, shall not be liable to the corporation with respect to such shares.

"(2) A shareholder of a corporation formed under this chapter shall not be personally liable for any debt or liability of the corporation.

"(4) Nothing in this chapter is intended to be in derogation of any rights which any person may have under the common law or the principles of equity against an incorporator, subscriber, shareholder, director, officer or the corporation because of any fraud practiced upon him by any such persons, or the corporation; or in derogation of any rights which the corporation may have because of any fraud practiced on it by any of such persons." (effective July 1, 1946) (Baldwin's Kentucky Revised Statutes, Third Edition, Chapter 217, pp. 12-13)

(d) KRS 271A.125 (1) and (5)

"271A.215 Liability of subscribers and shareholders.

"(1) A holder of or subscriber to shares of a corporation shall be under no obligation to the corporation or its creditors with respect to such shares other than the obligation to pay to the corporation the full consideration for which such shares were issued or to be issued, which in no event shall be less than the consideration for which such shares could be lawfully



issued, and otherwise to comply with the terms of the subscription.

"(5) A shareholder of a corporation shall not be personally liable for any debt or liability of the corporation, except as he may be liable by reason of his own conduct or acts." (effective July 1, 1972)(Bobbs-Merrill Kentucky Revised Statutes, Volume 10, 1976 Cumulative Supplement, p. 123)

## STATEMENT OF THE CASE

SUMMARY - The plaintiff-petitioner became a paraplegic as a result of a shooting accident involving a pistol manufactured by Erma Werke GMBH a German business. The plaintiff sued Erma alleging several bases of products liability. Though actually served, Erma defaulted and plaintiff obtained a default judgment against Erma. Later plaintiff learned of the relationship between Lear Siegler, Inc., hereinafter referred to as LSI, and Erma. Plaintiff filed suit against LSI based upon the judgment against Erma. Erma Werke GMBH is a German pseudo-corporation wholly owned by LSI. It was demonstrated that Erma's default had been pursuant to a policy made by LSI for Erma, designed to force any United States products liability suit against Erma to be brought in Germany. Erma has no assets in the United States. The district court found LSI to have an extensive right of control over its subsidiary, and further found

this control had been exercised to assure that Erma would not respond to any United States products liability suits other than in Germany. The district court determined that LSI's use of its corporate control to achieve this purpose was an abuse of the corporate franchise and held Erma's separate corporate existence should not be recognized. The Sixth Circuit reversed finding LSI's policy of not subjecting any of Erma's assets to claims in the United States did not constitute an abuse of the privilege of doing business as separate corporations.

Note: Page references are to the Appendix as prepared for the Sixth Circuit Court of Appeals.

On February 28, 1968, the plaintiff-petitioner Joe Terry Poyner, hereinafter referred to as Poyner, suffered a gunshot wound which has left him very seriously injured (p. 42, 43). On July 18, 1969 suit was filed on behalf of Poyner in the U. S. District Court for the Western District of Kentucky against the German manufacturer of the pistol involved, Erma Werke GMBH, and L. A. Distributors, Inc., the firm importing the pistol in question (pp. 20, 21). The complaint alleged several bases of products liaility (pp. 20-22). Although Erma received actual notice and a copy of the Complaint (p. 23), Erma has never at any time made an appearance of any sort. After duly entering Erma's default, and having a hearing on damages, judgment was



entered against Erma by the court (p. 49-54). This judgment was entered on July 5, 1972 (p. 49-54). On July 5, 1973, the plaintiff filed a supplemental complaint against LSI alleging that, due to LSI's relationship with Erma and its involvement in the suit against Erma, LSI should be held liable for the judgment against its wholly owned subsidiary, Erma (pp. 67-69).

RELATIONSHIP BETWEEN ERMA AND LSI - LSI is the sole owner of Erma (p. 93). LSI purchased Erma as a going concern in 1966 (LSI's sup. to int. ans. number 9, p. 88). A GMBH is not a true corporation, at least not in any form recognized in this country. Relevant attributes of the German GMBH form of doing business are set out in a law journal article stipulated into evidence by the parties, "GMBH: The Close Corporation in Germany - Management and Capitalization Problems for U.S. Controlled Subsidiaries", Winkaus and Stratmann, 28 Bus. Law. 1275 (1973) (hereinafter cited as Bus. Law.). That article (at pp. 159-199 in appendix) provides in pertinent part as follows:

> "General Characteristics. The GmbH is similar, though not identical to, the U.S. 'Close Corporation' or the 'Private Company' under English law. Most characteristic is that the capital in general is held by a few persons, individuals or corporations, and that in practice ownership and management are very often vested in the same persons." (Id at p. 161)

"In its dealings with third parties, the GmbH is represented by the Geschaftsfuhrer (Manager), although all corporate powers are vested for internal purposes in the shareholders." (Id at p. 162) (Parenthetical remarks added)

"The shareholders may intervene and interfere at any time they wish. In contrast to the Stock Corporation there is no nucleus of original and unalienable powers of the Geschaftsfuhrer, thus making the GmbH a most flexible management instrument. Instructions given by the shareholders are not subject to any limitations." (Id at p. 169) (Footnotes omitted)

"The Geschaftsfuhrer may be removed at any time by shareholders' resolution, with or without cause . . ." (Id at p. 171)

"All corporate power is vested in the shareholders." (Id at p. 172) (Footnote omitted)

"Any time, form, service or other of a shareholders' meeting can, by unanimous vote, be waived. For all practical purposes, the shareholders' meeting therefore is not necessary." (Id at p. 174)

"Under the Limited Liability Company's (GMBH) Act there is not such a clear-cut division of functions



within the corporate structure. The shareholders' meeting of a stock corporation cannot interfere in the day-to-day practice of the Vorstand, whereas the shareholders of a GmbH may give detailed instructions to the Geschaftsfuhrer." (Id at p. 180) (Footnotes omitted) (Parenthetical remarks added)

"The GmbH is a corporation and thus a legal entity separate from its shareholders. It may acquire rights of its own and act under its own name. The shareholders do not share in property rights and other titles held by the GmbH.

"The liability of shareholders is limited to the amount of the nominal value of capital they hold in the GmbH (quota share). Once the nominal capital is paid in, no further claims can be made against the shareholders -- unless the creditors show facts which result in 'piercing the corporate veil,' or establish a manifest case of willful detriment (BGB §826). Although not identical, cases of 'piercing the corporate veil' under German law are very similar to those under U. S. common law." (Id at pp. 161-162)

In addition to being the sole owner of Erma, LSI's officers are the only directors of Erma (LSI int. ans. 15(a), 39, pp. 89, 75-76). Beginning soon

after LSI acquired Erma, records were no longer kept of any meetings of the Board (LSI's int. ans. 38, p. 75).

LSI's STRATEGY FOR ERMA TO AVOID U.S. LIABILITY - In November, 1966, the first U.S. claim against Erma based on a defect in one of Erma's products was filed (LSI int. ans. 22, pp. 60-61). In two letters from W. O. Schmidt, corporate counsel and officer in LSI, to Karl Schmidt, the German manager of Erma, LSI's plan for handling litigation arising from U.S. products liability claims against Erma are set forth. In these two letters (pp. 114-120), the German manager was warned not to have any contact with any party in the United States other than W. O. Schmidt, corporate counsel with LSI. The stated reason for this was:

> "In the event the service of summons on Erma was proper, and if the personal injury is held to be the logical consequence of the defective firearm, then Erma's failure to make an appearance in court may result in a default judgment being rendered against it. From the German associate of the New York firm, it was learned that United States courts and German courts do not have reprocity. That is, a judgment rendered in one country is not given full faith and credit in the other without a court action on that judgment in the other country. Therefore, if a



> default judgment is rendered in New York, it can only be satisfied against Erma in West Germany. At that time Erma, through its West German attorneys, can attack the validity of that judgment based on the lack of jurisdiction of the New York court.
>
> "It is recommended that jurisdiction over Erma in the New York court action, if necessary, be contested in Germany rather than in New York. This is based upon economy. The costs of attorney fees and court costs which may be encountered in New York, particularly in the event of an initial adverse decision on jurisdiction, could quickly overshadow the $25,000 damages asked in the present action. Additionally, the New York court may favor the claimant over a foreign corporation. In West Germany, Erma would have the favorable environment in which to contest the New York court's lack of jurisdiction."

When the present suit, by Poyner, was filed against Erma, Karl Schmidt, the German manager, applied the same strategy, indicating that this was part of established procedure under LSI's instructions. His letters in respect to the Poyner suit to LSI's corporate counsel read in pertinent part as follows:

"We don't have the slightest idea in regard to the subject of this law suit in the amount of $750,000.00. . . . Our side will neither correspond with Imperato nor do anything in this case. We ask you, however, if he should give Imperato technical assistance through you as a neutral middle man. (p. 126)

"Enclosed is the copy of a notice in which we are named as defendant beside L.A. Distributors. We have no further knowledge of that matter, and, as usual, will not answer that letter, but inform you hereby. . ." (Emphasis added)(p. 130)

In April, 1972, several months before plaintiff sought entry of default against Erma, LSI's corporate counsel wrote the following instruction to the German manager:

> "It is our strategy to, first, help the attorney for the L.A. Distributors Insurance prove that the Erma pistol was not at fault. In this way we can contest the facts in the case without putting Erma into the court's jurisdiction. That is, they must still sue Erma in Germany no matter what the outcome. Second, that LSI is not directly involved in this case." (p. 143)

Both LSI and Erma knew Erma's pistols were widely distributed in the U.S. -- Erma was selling guns to R. G.



Industries in Miami, Florida, with direct negotiations between Erma, the American importer and LSI (LSI's int. ans. 42, p.78). LSI knew Erma had a direct agreement with L. A. Distributors, the New York importer of Erma's products, that L. A. Distributors would supposedly be the exclusive distributor for Erma's products (L.A.'s int. ans. 4, p. 102-103). It would seem reasonable to infer Erma would not have entered an exclusive distributorship agreement with L.A. Distributors without knowing the ability of L.A. Distributors to distribute the products, and the geographic scope of its distribution. L.A. Distributors advertises nationwide. L.A. Distributors sells to at least one distributor in Lexington, Kentucky. L.A. has a salesman in Tennessee, and a warehouse in North Carolina. L.A. Distributors has solicited business in Kentucky through phone calls and mail order catalogs and through national sporting goods conventions in Chicago (L.A.'s int. ans. 9-13, p. 35). In LSI's corporate counsel's letter to the German manager, dated May 12, 1971, LSI's attorney is discussing his attempts to collect notes due Erma from L.A. Distributors, apparently for L.A. Distributors' inventory of Erma's products. Erma subsequently obtained a judgment against L.A. Distributors in Germany for over $50,000 (LSI's int. ans. 18, pp. 95-96). This is a good indication that Erma's sales to American distributors are neither random nor small. In the correspondence between LSI's attorneys and officers and the

German manager (pp. 113-159), there are repeated references to direct contact regarding contracts by Erma with both L.A. Distributors and R. G. Industries. Considering this direct and repeated contact with at least two importers in the United States, and further considering the nature of Erma's product, .22 caliber semi-automatic pistols, it is difficult to deny that both Erma and LSI knew the U.S. was a major and regular marketplace for Erma's guns. Considering the nature of Erma's products, the prospect of personal injury products liability injury claims in the U.S. rose to a virtual certainty.

The district court specifically found, and the Court of Appeals did not disturb the finding that products liability claims in the U.S. were very much an expected liability of Erma's business. The district court found expressly, and the Court of Appeals tacitly, that LSI was responsible for a consciously adopted strategy whereby Erma would not appear in any products liability suit in the United States. Since Erma had no U.S. assets, the hoped for result of this strategy would be, any U.S. claim against Erma could only be successful by suit in Germany. The district court found that this strategy, for which LSI was responsible, was sufficiently inequitable to justify disregarding the corporate identify of Erma. The Sixth Circuit Court of Appeals, reversed the district court on the sole point that, under its view of Kentucky



precedent, there was not authority for disregarding the corporate entity when corporate control was being utilized to force Kentucky claimants to bring suit in a foreign court. The Court of Appeals opinion also emphasized that LSI had done no more than continue the status quo. As earlier discussed, there were no U.S. products liability suits against Erma before LSI acquired Erma. There was no status quo pre-LSI! Similarly, were there not substantial likelihood that, Karl Schmidt, the German manager of Erma, would have become involved in U.S. products liability suits, it is difficult to perceive why LSI's corporate counsel wrote three separate letters to the German manager, each of which telling the German manager not to have any contact with any litigant in U.S. products liability actions (p. 114-121).

## ARGUMENT

### I. DOES ERIE R. CO. V. TOMPKINS REQUIRE A FEDERAL COURT TO APPLY FORTY YEAR OLD FORUM STATE CORPORATION CASE LAW WITHOUT ANY ANALYSIS OF PUBLIC POLICY FACTORS TO A GERMAN BUSINESS ENTITY WHICH IS NOT EVEN A TRUE CORPORATION?

The Sixth Circuit's Opinion concludes:

> "This is the sort of appealing case which might have led the Kentucky courts to reexamine the doctrine of limited liability, or at least to

> further limit its application. However, we must apply the law as it appears in existing Kentucky decisions. We believe that it would be an unprecedented extension of the Kentucky doctrine to disregard Erma's separate corporate existence in this case."

There are several factors present in the instant case indicating the Sixth Circuit Court of Appeals has misapplied Erie R. Co. v. Tompkins, 304 U.S. 64 (1938).

Kentucky's case law on the subject of disregarding corporate entity is dated. In the 1975 Kentucky Law Journal article cited by the Sixth Circuit, Campbell, "Limited Liability for Corporate Shareholders: Myth or Matter-of-Fact", 63 Ky.L.J. 23, 48 appears the following discussion of the present state of Kentucky law:

> "While it is clear that the Court of Appeals will disregard the corporate entity in some instances, its past decisions are of minimal help in assessing the present state of the law. Initially, one is confronted by the problem that there are a limited number of reported cases in which this issue has been raised. Moreover, since most of those decisions are forty or more years old, there could be some doubts as to their continued vitality as precedent."



The Sixth Circuit's Opinion discussed only one case, less than forty years old, in which the Kentucky Court of Appeals had refused to disregard the separate corporate entity, Big Four Mills v. Commercial Credit Co., 307 Ky. 612, 211 S.W.2d 831 (1948); and as can be readily seen, this decision is almost thirty years old.

In addition to the age of the decisions relied upon by the court below, there remains the salient point that the instant case involves both facts and other areas of the law which were not, and could not have been, included in the analysis of an appelate court forty years ago. Not the least of these factors is the hybrid nature of a German GMBH. The extent of direct control exercised by a shareholder over his corporation has always been a heavy factor in all jursidictions, including Kentucky in determining whether the shareholder may be liable for the obligations of its corporation. 63 Ky. L.J., supra at 49. As noted in the Bus. Law. article on the form of business known as GMBH, German law allows open, direct and unfettered shareholder control over this form of doing business. This unfettered control is more characteristic of a partnership. Thus, what is one indicia of an abuse of the corporate franchise by an American shareholder, is granted as a matter of law with respect to this German form of doing business.

Only through the incredible technological advancement that has occurred over the last forty years would it have been possible for an American owner to zip off, via telex, same day instructions to the German manager of his GMBH. The growth of multi-national corporate structures and the huge increase in international trade in manufactured goods give rise to public policy considerations from a case such as this one which could not have been considered thirty or forty years ago.

The mushrooming of both the volume and geographic scope of trade has occasioned far-reaching changes in other areas of the law. Both the Kentucky courts and its legislature have readily and speedily adapted. Kentucky was among the first jurisdictions to adopt strict liability, a la §402A of the Restatement 2d of Torts. Dealers Transport Co. v. Battery Distributing Co., 402 S.W.2d 441, 446, 447 (Ky., 1966). Kentucky early adopted a long-arm statute designed to reach those with minimal contacts with the forum. KRS 454.210 (1968); Etheridge v. Grove Manufacturing Company, 415 F.2d 1338, 1340 (6th Circuit, 1969). It is difficult to deny that by adopting §402A of the Restatement 2d of Torts, Kentucky was expressing firmly the policy that manufacturers of consumer goods should bear the burden of injuries caused from defective products. Similarly it is difficult to deny that by enacting KRS 454.210 Kentucky lawmakers intended to



extend to the fullest the power of their courts to provide redress against nonresidents for injuries occurring in Kentucky.

Since the 1930's, Kentucky statutes on corporate shareholder liability have repeatedly been liberalized. The applicable statute in 1936, Carroll's Statutes §547, provided in substance that stockholders were liable to the extent of the value of their shares, period. In 1946 the same principles were covered by KRS 271.215, but effective in 1946, in subpart (4) the following was added:

> "(4) Nothing in this chapter is intended to be in derogation of any rights which any person may have under the common law or the principles of equity against an incorporator, subscriber, shareholder, director, officer or the corporation because of any fraud practiced upon him by any such persons. . ."

In 1972 the applicable statutory provision was KRS 271A.125, which eliminated any specific requirement of fraud and provided:

> "(5) A shareholder of a corporation shall not be personally liable for any debt or liability of the corporation, except as he may be liable by reason of his own conduct or acts."

(All of the above statutes are set out

fully on pages 4-7 herein. Thus in the past forty years, when there is a virtual void in case law on the subject, Kentucky statutes have progressed from the flat statement that shareholders are not liable, to shareholders may be liable for fraud, to shareholders may be liable by reason of their own conduct.

Where there is no clearly applicable decision of the state's highest court, it is incumbent upon the Federal Court to look to "all available data" to chose the rule which it believes the state court, from all that is known about its methods of reaching decisions is likely in the future to adopt. Putnam v. Erie City Mfg. Co., 338 F.2d 911, 917 (5th Cir., 1964). The notion that Federal courts will woodenly apply state decisions of dubious current vitality encourages the very forum shopping which Erie R. Co. v. Tompkins, supra, sought to stop. See annotation "Federal Courts -- Duty to Follow State Courts", 18 L.Ed.2d 1602, 1606. A litigant in the Kentucky courts would reasonably expect new factual circumstances created by ever-expanding world trade and ever-increasing international corporate sophistication to require a Kentucky court to examine not only its forty year old precedents, but also the state's policies as set out in its statutes, and its interests in protecting its own citizens. The very essence of Erie R. Co. v. Tompkins, supra, requires the Federal Courts to do no less than apply the law as it earnestly believes



the state courts would. Since there is no Kentucky decision involving the inter-relation between Kentucky law and the German GMBH form of doing business; since there is no Kentucky Law concerning an American parent corporation affirmatively interfering to keep its GMBH's assets from Kentucky consumers; and since all of these forty year old decisions pre-date Kentucky's firm adoption of strict products liability, it is respectfully submitted that the Sixth Circuit Court of Appeals has misapplied Erie R. Co. v. Tompkins, supra. While it is clear the lower court's opinion was correct in saying that upholding liability against LSI was unprecedented; it is equally true that denying LSI's liability is unprecedented. Insofar as the Sixth Circuit Court of Appeals has held: in absence of specific forum state authority, plaintiff loses, its decision is wrong, and should be reversed.

II. IF A PARENT COMPANY EXERCISES ITS CONTROL OVER A WHOLLY-OWNED SUBSIDIARY TO ACCOMPLISH A RESULT WHICH IS INEQUITABLE TO FORESEEABLE KENTUCKY CREDITORS, WOULD KENTUCKY COURTS HOLD THE PARENT CORPORATION ACCOUNTABLE TO THOSE KENTUCKY CLAIMANTS?

The district court's Opinion aptly summarized existing Kentucky precedent with respect to disregarding the separate corporate entity; the court concluding as follows:

"Whether the courts will disregard the separate corporate entity is a decision which has to be made upon the facts of each case. The Kentucky courts have not found it always essential to go through all of the indicia urged by the defendant. While the indicia of control are important, the primary concern which runs through the case law seems to be whether, in each particular instance, the privilege of separate corporate existence was being abused." (App. pp. 5-6)

In 63 Ky.L.J., supra, at 49:

"An examination of the reported cases, however, reveals nothing radical in the Kentucky approach. On the contrary, the Kentucky Court of Appeals appears to be sensitive to the same factors as the courts in other jurisdictions."

The trial court's conclusion concerning the "instrumentality rule" or "alter ego" is supported by the analysis of this Court in Taylor v. Standard Gas & E. Co. 306 US 307, 322 (1938) in which it was stated:

"Petitioners invoke the so-called instrumentality rule, -- under which, they say, Deep Rock is to be regarded as a department or agent of Standard, -- to preclude the allowance of Standard's claim in any amount. The rule was much



discussed in the opinion below. It is not, properly speaking, a rule, but a convenient way of designating the application, in particular circumstances, of the broader equitable principle that the doctrine of corporate entity, recognized generally and for most purposes, will not be regarded when so to do would work fraud or injustice."

An excellent example, arising in Kentucky is Anderson v. Abbott, 321 US 349 (1943). In Anderson, id, holders of bank stock, carrying the possibility of double liability for shareholders, exchanged this stock for shares in a holding corporation. It was expressly found that the holding corporation was not a sham, was organized in complete good faith and not for fraudulent purposes. Some of the banks operated by the holding company failed. The shareholders of the holding corporation maintained they were not liable for double liability on bank stock because the only stock they held was in the holding corporation, which was not a bank. In deciding the separate entity of the holding corporation must be disregarded, Mr. Justice Douglas stated as follows:

"Limited liability is the rule not the exception; and on that assumption large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted.

But there are occasions when the limited liability sought to be obtained through the corporation will be qualified or denied. Mr. Justice Cardozo stated that a surrender of that principle of limited liability would be made 'when the sacrifice is essential to the end that some accepted public policy may be defended or upheld.' Berkey v. Third Ave. R. Co. 244 NY 84, 95, 155 NE 58, 50 ALR 599; United States v. Milwaukee Refrigerator Transit Co. (CC) 142 F 247. See Powell, Parent & Subsidiary Corporations 1931, pp 77-81. The cases of fraud make up part of that exception. Linn & L. Timber Co. v. United States, 236 US 574, 59 L ed 725, 35 S Ct 440; Rice v. Sanger Bros. 27 Ariz 15, 229 P 397; Donovan v. Purtell, 216 Ill 629, 640, 75 NE 334, 1 LRA(NS) 176; George v. Rollins, 176 Mich 144, 142 NW 337; Higgins v. California, Petroleum & Asphalt Co. 147 Cal 363, 81 P 1070. But they do not exhaust it. An obvious inadequacy of capital, measured by the nature and magnitude of the corporate undertaking, has frequently been an important factor in cases denying stockholders their defense of limited liability. Luckenbach S. S. Co. v. W. R. Grace & Co. (CCA 4th) 267 F 676, 681; Oriental Invest. Co. v. Barclay, 25 Tex Civ App 543, 559, 64 SW 80, 88. And see Weisser v. Mursam Shoe Corp.



(CCA 2d) 127 F(2d) 344, 145 ALR 467. Cf. Pepper v. Litton, 308 US 295, 310, 84 L ed 281, 291, 60 S Ct 238, 41 Am Bankr Rep(NS) 279; Albert Richards Co. v. The Mayfair, 287 Mass 280, 288, 191 NE 430; Erickson v. Minnesota & O. Power Co. 134 Minn 209, 158 NW 979. That rule has been invoked even in absence of a legislative policy which undercapitalization would defeat."

This is the law in Kentucky. While the Sixth Circuit distinguished Hermitage Land & Timber Co. v. Scott's Executrices, 263 Ky. 651, 93 S.W.2d 1 (1936) on a superficial basis, it should not be dismissed lightly. Here the Kentucky court refused to recognize a corporation apart from its two principal shareholders. These two individuals had signed a contract concerning their corporation's property but their signatures did not indicate that this was on behalf of their corporation. The two shareholders tried to avoid the corporation's liability under the contract because there had been no formal corporate consent to the contract. The evidence showed the shareholders were officers in the corporation and they owned nearly all of its stock. The opinion discussed the shareholder's activities only in regard to the transaction in question. While, as noted by the Sixth Circuit, this decision deals with a contract question, it is equally clear the court in that Kentucky case

did not make an elaborate recitation of whether the shareholders kept separate files for their corporations, account systems, inter-corporate loans, etc. The court simply looked at the situation; saw that it would be inequitable to allow the recognition of the separate corporate existence, and ruled accordingly. This is Kentucky law squarely falling within the principle that dominant shareholders, closely controlling a corporation and attempting to use that corporation's separate entity for an inequitable purpose will not be allowed to do so.

III. IS IT INEQUITABLE FOR A CALIFORNIA BASED PARENT OF A GERMAN SUBSIDIARY COMPANY TO INSTRUCT THAT SUBSIDIARY, A FIREARMS MANUFACTURING PLANT, NOT TO RESPOND TO ANY PRODUCTS LIABILITY CLAIMS IN THE UNITED STATES WHERE MANY OF ITS PISTOLS ARE SHIPPED?

Recognition of the separate corporate entity of Erma results in forcing anyone injured in the United States as a result of Erma's products to ultimately litigate his claim in West Germany, or forget it. In the instant case it has been demonstrated all of Erma's directors are officers in LSI, working in LSI's Santa Monica, California office. The extensive right of control maintained by the owner of a GMBH over a GMBH is attested by the law review article admitted into evidence. LSI completely



owns Erma. As found by both lower courts, LSI was responsible for Erma's policy of not submitting to the jurisdiction of any U.S. court. With those elements established, it would seem clear that an appropriate case for disregarding Erma's corporate entity is established if, under Kentucky law, LSI exercised its ownership and right of control in such a manner as to cause a result which is condemned by Kentucky courts.

Undercapitalization is an evil recognized in Kentucky case law as an inequity justifying the disregard of the separate corporate entity. In Chesapeake Stone Co. v. Holbrook, 168 Ky. 128, 181 S.W. 953 (1916) two corporations were owned by the same people. One corporation owned a rock quarry, while the other, at least nominally, operated the same quarry. The corporation which was operating the quarry was kept stripped of assets by the other corporation. The plaintiff, a workman seriously injured while working at the quarry, sought to recover from the solvent corporation. The defendants interposed the separate corporate entity of the operating corporation, which was without assets. The Kentucky Court of Appeals held in these circumstances the separate corporate entity should be disregarded.

This conclusion is buttressed by 63 Ky.L.J., supra, at 53 where it is found:

> "It is entirely sound to consider undercapitalization as an unfair act that necessitates the disregard of the corporate entity."

As cogently expressed in Dix, "Adequate Risk Capital: The Consideration for the Benefits of Separate Incorporation", 53 Northwestern University Law Review 478, 483, 484 (1958):

> "Contribution of risk capital to respond to the corporation's debts is the required consideration for the stockholder's personal immunity. . . . Stockholder contribution of risk capital adequate to make the corporation self-sufficient is the fundamental conception at the basis of the corporate cover for stockholder's individual liability. It is not unreasonable. It is moral.
>
> "Whatever the real motive and purpose of the stockholders, the courts will not tolerate any arrangements which would throw all the risks and hazards of the business upon the public who deal with it, and at the same time enable the stockholders to realize all possible gains while being secured against loss in the event the enterprise should prove unprofitable."

It of course can be argued that Erma has assets and therefore is not undercapitalized. The logical response,



and one which Kentucky authority indicates should be given here, is assets in so inaccessible a location as West Germany are equivalent to no assets at all. It should be remembered that LSI is seeking the benefits of limited liability for its GMBH in this country. Yet it has taken affirmative action to insure that none of its subsidiaries' assets will be subjected to the jurisdiction of this country's courts. Admittedly a different form of corporate manipulation was involved in American Railway Express Co. v. Commonwealth, 190 Ky. 636, 228 S.W. 433 (1920), however, there are some striking similarities between the issues presented in that case and the present one. The Commonwealth of Kentucky sought to make one corporation liable for certain judgments it already had obtained against a second corporation. Both corporations involved, the American Railway Express Company and the Adams Express Company, were legitimately formed corporations with substantial assets. American purchased Adams. Adams had for many years maintained a business in Kentucky. In exchange for all of the assets of the Adams' company, its shareholders were given stock in the American. While the sale was bona fide, it had the practical effect of removing from Kentucky all assets of the Adams company which previously would have been available to satisfy Kentucky creditors of the Adams Company. In holding the purchasing corporation liable for judgments rendered against the separate corporation, the Kentucky court held as follows:

"But it is said that the Adams is yet a corporation, and owns property more than sufficient to satisfy its debts. It is true that it yet has a corporate existence, but no suit can be maintained against it in this state, and all of its property that had a situs in this state has been taken from it. So far as Kentucky creditors are concerned, it is nothing more than a mere shell, and a very empty one at that. If it owns tangible property of value, none of it is in this state, and more than likely it has none outside the state that can be seized and subjected by pursuing creditors. At any rate, it is plain that the creditor in this state, in order to make his debt, would be required to go to the state of New York and find there, if he could, property to satisfy his debt, and then resort to the courts of New York to try and collect it. We say this because the Adams Company, so far as this record shows, has no disposition to pay this debt, and, we may assume, will resort to every possible means to defeat its collection. . . .

"When the American bought the Adams, that company had for years been engaged in an extensive business throughout the United States, and the American must have known that it had liabilities; but no



provision whatever was made for their payment, and it now says to the creditors of the Adams in Kentucky, 'If you want your money, go to the state of New York and try to get it.' We will not give our sanction to a scheme like this, and the conclusion we have reached is supported by abundant authority." (Id, pp. 441, 442)

While this case can be distinguished since it involved a corporate sale of assets, it is difficult to read this decision and not feel the Kentucky courts take a dim view of forcing foreseeable Kentucky creditors to sue in a foreign forum. With two U.S. importers it is difficult to believe that products liability claims in this country were not a foreseeable liability of Erma's business. LSI took affirmative steps to assure that Erma would not subject itself to the jurisdiction of U.S. courts. It seems incongruous for LSI to ask those same courts to extend to LSI the privilege of limited liability. It is deriving all benefit from Erma's business in this country, while effectively insulating itself from the possiblity of loss. The rationale of the undercapitalization cases applies clearly.

It is earnestly contended that Kentucky courts would show no hesitancy in imposing liability on LSI in this circumstance. What purpose, either in equity or economics is served by

allowing LSI to limit its liability to assets in Germany for business which its subsidiary is conducting in the United States. This is especially true where LSI has affirmatively interfered, not just passively allowed the status quo to continue, to see that any claim made against LSI's German investment must ultimately be decided before a German court.

There is little reason for a U.S. owned and controlled firm being immune from the same courts that govern the rest of us, simply by virtue of being located in Dachau.

An analysis of the policy considerations involved should rather forcefully indicate Kentucky courts would not have decided this case as did the Sixth Circuit Court of Appeals. Kentucky's well-established rules of law are designed to effectively place liability for personal injuries on the manufacturer of products causing them. Allowing LSI's scheme to work frustrates this purpose. If LSI, because of its attempt to dodge responsibility, is held liable, it obviously can pass on to its wholly-owned subsidiary (the manufacturer) liability to the injured consumer. The interests of a Kentucky court in favoring West German investment by a California based corporation would seem minimal. With ever-expanding world trade, it seems incongruous to foster a rule of law encouraging American companies with foreign subsidiaries to be certain their



foreign investment remained unresponsive to claims filed in U.S. courts.

## CONCLUSION

The instant case involves an extremely important issue of state law. It also has an international aspect, and poses problems which must eventually be faced in many jurisdictions in addition to Kentucky. The lower courts are faced with a factual situation which had never been resolved by the state courts. Rather than apply an analysis of the state interests involved or the developments in related fields of law, the Sixth Circuit Court of Appeals determined that in the absence of some close precedent establishing the plaintiff's right of recovery, the plaintiff's case must fail. That result is inconsistent with known Kentucky policies which favor manufacturer's liability for consumers injured from defects in their products; it frustrates clear Kentucky policy favoring the ability of an injured Kentucky citizen to be able to obtain redress in a local court. It serves no purpose other than fostering irresponsibility by multi-national corporate structures.

Respectfully submitted,

WILLIAMS, HOUSMAN & SPARKS

By _____
1700 Kentucky Avenue
Paducah, Kentucky 42001

Attorneys for Petitioner



CERTIFICATE OF SERVICE

I, Charles A. Williams, counsel for Joe Terry Poyner in the matter styled "Joe Terry Poyner, by and through his statutory guardian, Dorothy Poyner vs. Lear Siegler, Inc." do hereby certify that I served three true copies of the foregoing petition (with Appendix) for a writ of certiorari to the United States Court of Appeals for the Sixth Circuit on the 23 day of February, 1977, by depositing same in a United States mailbox with first class postage prepaid, addressed to Threlkeld, Whitlow & Roberts, P.O. Box 995, Paducah, Kentucky 42001, attorneys for respondent Lear Siegler, Inc.; to Boehl, Stopher, Graves & Deindoerfer, Citizens Bank Building, Paducah, Kentucky 42001, attorneys for L.A. Distributors, Inc.; to McMurry & Livingston, Citizens Bank Building, Paducah, Kentucky 42001, attorneys for Lee Dyer and Robert Dyer; and to Earle T. Shoup, Citizens Bank Building, Paducah, Kentucky 42001, attorney for Insurance Company of North America.

WILLIAMS, HOUSMAN & SPARKS

By _____
Chas. A. Williams
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APPEXDIX "A"

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF KENTUCKY
AT PADUCAH

Civil Action No. 1981-P

JERRY TERRY POYNER — PLAINTIFF

V.

ERMA WERKE GMBH
and
L. A. DISTRIBUTORS, INC. — DEFENDANT AND THIRD PARTY PLAINTIFF

V.

LEAR SIEGLER, INC. and — THIRD PARTY DEFENDANTS

V.

LEAR SIEGLER, INC.
and
INSURANCE COMPANY OF
NORTH AMERICA — DEFENDANTS TO SUPPLEMENTAL COMPLAINT

OPINION, FINDINGS OF FACT
AND CONCLUSIONS OF LAW

The case between the plaintiff, Joe Poyner, and the defendant to the supplemental complaint, Lear Siegler, Inc., was by agreement tried to the Court without a jury on October 29, 1974. Neither the plaintiff nor the defendant produced any witnesses at the trial. The case was submitted on the pleadings and responses to interrogatories and requests for production



which had been filed. This case arose through a shooting accident which left the plaintiff a permanent paraplegic. Suit was filed against the German manufacturer of the pistol involved, Erma Werke GMBH, and the importer of the pistol, L. A. Distributors, hereinafter referred to as Erma and L. A., respectively. The importer, L.A., by third-party complaint, brought in Lear Siegler, Inc., hereinafter LSI, as a third-party defendant from whom was sought indemnity and contribution. Erma, although actually served with process, has never, through counsel or otherwise, appeared in this action. Upon motion by the plaintiff, default was entered against Erma in May, 1972. After entry of default by the clerk on June 2, 1972, and after a hearing on damages, the Hon. Charles M. Allen, U. S. District Judge for the Western District of Kentucky, entered judgment for the plaintiff, Joe Poyner, on July 5, 1972, in the amount of $398,830.77 against Erma Werke GMBH.

Plaintiff in July of 1973, filed supplemental complaint against LSI, seeking to recover from LSI the judgment obtained against Erma. It is this claim which was tried to the Court on October 29, 1974. It is this claim which is the subject of this Opinion, Findings of Fact and Conclusions of Law.

The pleadings and the interrogatory responses show, and the Court finds to be fact, the following: The Court has jurisdiction over the subject matter here involved, LSI is a corporation with its home office in Santa Monica, California. Erma is a wholly-owned subsidiary of LSI and has been at all times relevant to the supplemental complaint. Erma is a German business entity known by the abbreviation

"GMBH". A GMBH is not stictly analagous to an American corporation. The Court finds from the Business Lawyer article stipulated into evidence by the parties that a GMBH involves a greater degree of open and direct shareholder control and participation in management than that which is allowed normal American corporations. Specifically, the Court finds the shareholders are free to interfere at any time in the daily concerns of the GMBH, and the shareholders are not limited in any manner from directly and openly controlling the business. The Court further finds that there are actual incidents of this type of control shown between LSI and Erma. Since LSI's acquisition of Erma, the meetings of Erma's supervisory board have no longer even been held in Germany, nor are any German residents allowed on this board. Rather, LSI has staffed the aufsichstrat with its own home office employees and officers. No formal meetings have occurred and no records of any such meetings have been kept. LSI selects and pays lawyers to represent Erma's interest, both in the United States and in Europe. LSI's house counsel negotiate contracts in Erma's behalf in some of Erma's major markets. The evidence supports, and the Court finds, that LSI made the decision in the present case that Erma would default. The correspondence between LSI's lawyers and the German manager, Karl Schmidt, shows that LSI set the strategy for Erma in prior products liability, personal injury suits in the United States. This identical strategy was set out to be used in the Poyner case by W. O. Schmidt, at the time LSI's house counsel and officer. LSI's argument that Erma's default was an autonomous decision made by Karl Schmidt, the German manager, is belied by several factors. First of all, W. O. Schmidt, LSI's house counsel,



set out in a telex in so many words what strategy LSI planned for Erma. This was the same plan which had been set out in the earlier products liability personal injury case in New York. Even after LSI admits first learning of the claim against Erma--nothing changed. LSI's arguments that it did not have a right to file an answer for Erma in November of 1971 are very weak, in view of the fact that they never even tried. The plaintiff had not even asked for entry of default at the time LSI's W. O. Schmidt directed that Erma would not appear. The Court finds that LSI consciously adopted a strategy for Erma whereby Erma would not appear in a suit brought in the United States. Erma owned no assets in the United States, and any judgment obtained in the United States could only be enforced by a suit in Germany. Through LSI, Erma would still provide sub rosa assistance to other defendants in the suit in the United States. To actually recover on a claim against Erma in the United States, the plaintiff would have to not only prove his underlying claim against Erma, but, in addition, prove that LSI should be liable for Erma's obligations. The Court finds this was the scheme adopted in the present case. Even without the correspondence objected to by Lear Siegler, the record supports, and the Court finds, that Lear Siegler controlled Erma's legal course in this lawsuit. It is firmly established that Lear Siegler had an unlimited right to make decisions for Erma. Lear Siegler admitted through its interrogatory answers that Lear Siegler's lawyers take care of Erma's legal interests in the United States. The two members of Erma's aufsichtsrat were both home office employees of Lear Siegler, and had been since soon after Lear Siegler acquired Erma. Regardless of whether the text of the correspondence

between Lear Siegler and Erma is admissible, it is clearly relevant and admissible that there were many communications between Lear Siegler's officers and lawyers and the German manager of Erma about this lawsuit. This string of correspondence occurred well before the plaintiff asked for default judgment against Erma, and long before the default became final. The two officers of LSI in LSI's home office who comprised Erma's aufsichtsrat were sent copies of this correspondence. It was further admitted that these two men did discuss this suit with the German manager. Thus, the situation is this--a legal decision had to be made. LSI had the unfettered right to make that decision; LSI provided and paid its own house lawyers; Erma did not have any other counsel in this country; and Lear Siegler admits that its house counsel have always in the past taken care of Erma's legal interests in this country. Under these circumstances, the Court finds that Lear Siegler did control that legal decision.

There are two questions to be decided here: (a) Is LSI responsible for Erma's obligations; and, (b) if so, is the plaintiff's default judgment against Erma such an obligation? Sitting in a diversity case, this Court is bound to apply the substantive principles of Kentucky law. The questions involved in this case appear to be unique. This Court, however, believes that the Kentucky courts applying established principles of Kentucky law would answer the above two questions in the affirmative.

Whether the courts will disregard the separate corporate entity is a decision which has to be made upon the facts of each case. The Kentucky courts have not found it always



essential to go through all of the indicia urged by the defendant. While the indicia of control are important, the primary concern which runs through the case law seems to be whether, in each particular instance, the privilege of separate corporate existence was being abused. The Court finds that it has been so abused in this case. LSI, an American corporation, has adopted a strategy designed to force an injured American consumer to bring suit in Germany if any recovery is to be effected against the manufacturer, or to be faced with a double legal hurdle to get to LSI's assets in the United States. One would have to wonder if such a strategy would not present an insurmountable barrier to the injured plaintiff if his injuries were less severe. Regardless of the merit of any products liability claim, if the amount involved was not quite large, the prospect of having to either litigate in Germany or to have to prove both the products liability claim and the case for disregarding the separate entity fiction would be prohibitive. The Court finds that LSI exercised its control over Erma and consciously adopted this scheme. It is further found that such an arrangement works an unfair hardship on Erma's foreseeable American creditors. The same result, albeit by different device, has been denounced as constructively fraudulent by the Kentucky courts. American Railway Express Co. v. Commonwealth, 228 S.W. 433, 190 Ky. 636 (1920). For these reasons, the Court finds that, for purposes of this suit, the separate legal identity of Erma Werke GMBH should be ignored. That being the case, the sole shareholder, LSI, is responsible for Erma's obligations.

The remaining question is whether the plaintiff's default judgment against Erma is an obligation for which LSI is liable. LSI contends that it is entitled to open up the judgment against Erma and contest the merits of the plaintiff's case against Erma. The Court believes that LSI is bound by the judgment against Erma. This involves the question of what res judicata effect will be given the default judgment. As counsel for the defendant has pointed out, res judicata has two aspects, merger and bar, and collateral estoppel. Under the peculiar facts of this case, either aspect of res judicata applies.

It has long been established in Kentucky that one who has an interest in and who controls litigation is bound by the outcome of that litigation. This is true even though the participating non-party was not named as a formal party and was never served with process. Amburgey v. Adams, 245 S.W. 514, 196 Ky. 646 (1922). In Amburgey, the Kentucky Court of Appeals held that the participating non-party was bound by the earlier judgment, even though that judgment was not based on the merits. Here, LSI had the requisite interest in the outcome of any suit against Erma Werke. Without the separate corporate entity fiction, Erma is nothing more than a factory owned by LSI. Even with the fiction, since LSI is the sole shareholder in Erma, whatever happens to Erma necessarily affects LSI to an equal extent. A closer union of interests would be difficult to imagine.

As earlier discussed, the Court finds that LSI controlled Erma's legal course. It was argued that a default judgment is, ipso facto,



not "litigation" within the meaning of "controlling litigation." That might be so in some instances, but it carrys little import here. In the present case the Court finds that this default judgment was part of a reasoned, legal strategy designed to provide Erma and LSI with substantial, unfair advantages over the other litigants. In these circumstances, determing (sic) that Erma would not appear, but would give sub rosa assistance to other defendants, is controlling litigation in a very real sense. Thus, both criteria are met, control and interest. LSI will not be heard to open up the judgment against Erma or litigate now, in its own name, those same questions it refused to litigate while acting in Erma's name.

In addition to the Court's finding that estoppel by judgment properly applies, the merger and bar aspect of res judicata is applicable. The Court finds in these circumstances LSI and Erma are "privies" or "in privity", such that the judgment against Erma is final and equally applicable to LSI. There is substantial authority that a closely held corporation and its shareholder(s) should be considered in privity for the purposes of res judicata. Sparks Nugget, Inc. v. C.I.R., 458 F.2d 631, 639 (9 Cir. 1972); Barzilay v. United States, 256 F.Supp. 1010, 1016 (S.D. Fla. 1966); Farmers' Bk. of Ky. v. Ohio River Line Steamboat Co., 108 Ky. 447, 456, 457, 56 S.W. 719 (1900). The Court finds that the German GMBH is even more closely identifiable in interest with its owners than an American closely held corporation. Therefore, this case presents an even stronger position for holding the parent and the subsidiary to be in privity. LSI's actual control over the decision for Erma to allow the default

judgment rather than appear in the United States adds to the conclusion that LSI should be bound by that decision and the resulting judgment against Erma.

The Court feels, as set out above, that the critical factual issue, whether LSI controlled Erma's course in the lawsuit, is supportable by the evidence without the correspondence to which the defendant objected. However, the correspondence plainly discloses that LSI was responsible for Erma's default. Since an issue was raised as the the application of the attorney-client privilege, the Court hereby rules that the attorney-client privilege did not apply; and even if it did so apply, in the special circumstances of this case, whatever harm might befall the attorney-client relationship is outweighed by the need to disclose the truth. The Court finds that neither Karl Schmidt nor Josef Eder were allowed to make the decisions concerning the Poyner case; rather, these decisions were being made by LSI's attorneys and officers. Lear Siegler's attorneys were not so much giving legal counsel to Karl Schmidt and Josef Eder, as they were making the decisions. If any true attorney-client relationship existed, it was tenuous.

The correspondence goes right to the heart of the issue. When W. O. Schmidt, LSI's house counsel and officer, wired Karl Schmidt and begins: "It is our strategy to . . .," and then sets out the strategy which was, in fact, followed, little doubt remains concerning the extent of Lear Siegler's participation. This is a key issue; there is no direct proof that could be offered on this issue that would not raise the same attorney-client question posed by Lear



Siegler. In view of this, the Court finds the admission of the correspondence will do far more good toward justly deciding this case than any harm which might thereby result to the attorney-client relationship. For these reasons, the Court finds the correspondence in question is admissible in evidence.

Lear Siegler's specific evidentiary objections based on competency, materiality, and relevancy are hereby overruled. The Court specifically finds that Karl Schmidt, W. O. Schmidt, Josef Eder and David Linehan were all agents of Lear Siegler, Inc., at least in regard to the matters involved in this lawsuit. The Court further finds that each of these men would be authorized by Lear Siegler to make the statements which were made in the subject correspondence. This being the case, the hearsay objection to the items of correspondence is ill-founded.

For the foregoing reasons, it is the conclusion of this Court that judgment should be entered in behalf of the plaintiff Joe Terry Poyner and against Lear Siegler, Inc.

May 1, 1975

/s/ JAMES F. GORDON
United States District Judge

Copies to:

Counsel of record.

APPENDIX "B"

No. 75-1939

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

| | |
|---|---|
| JOE TERRY POYNER, by and through his statutory guardian, Dorothy Poyner, Plaintiff-Appellee, v. LEAR SIEGLER, INC., Defendant-Appellant, | On Appeal from the United States District Court for the Western District of Kentucky at Paducah |

DECIDED AND FILED OCTOBER 14, 1976

Before: PHILLIPS, Chief Judge, McCREE, and LIVELY, Circuit Judges.

McCREE, Circuit Judge. Lear Siegler, Inc. (LSI) appeals from a judgment against it in behalf of Joe Terry Poyner (Poyner). The district court held LSI liable under a default judgment previously obtained by Poyner against Erma Werke GmbH[1] (Erma), LSI's wholly owned

[1] See Winkaus and Stratmann, "The Close Corporation in Germany - Management and Capitalization Problems for U.S. Controlled Subsidiaries," 28 Bus. Law 1275 (1973), which the



subsidiary. Because we conclude that under Kentucky law the separate corporate indentities of LSI and Erma should not have been disregarded, we reverse.

Poyner, a sixteen year old minor, received a serious injury when the .22 caliber pistol with which he and a friend had been playing accidentally discharged. The weapon, manufactured by Erma, had been exported by another West German firm and was distributed in the United States by L. A. Distributors, Inc. (L.A.), a New York Corporation. The gun had reached Kentucky when Poyner's friend gained access to it. Poyner is now a paraplegic as a result of his injury.

On July 18, 1969, Poyner filed an action in United States Distict Court for the Western District of Kentucky, alleging that his injuries

parties have stipulated into evidence. According to that article,

> [t]he GmbH is similar, though not identical to, the U.S. "Close Corporation" or the "Private Company" under English law. Most characteristic is that the capital in general is held by a few persons, individuals or corporations, and that in practice ownership and management are very often vested in the same persons.
>
> The GmbH is a corporation and thus a legal entity separate from its shareholders. It may acquire rights of its own and act under its own name. The shareholders do not share in property rights and other titles held by the GmbH.
>
> The liability of shareholders is limited to the amount of the nominal value of

had been caused by a defect in the pistol and seeking to recover damages from both L.A. and Erma. Pursuant to K.R.S. §454.210, the long-arm statute, service was made on both defendants through the Secretary of State of Kentucky. Both defendants received actual notice of the action. Nevertheless, Erma elected not to appear to defend the suit, and after hearing proofs of Poyner's damages, the district court entered judgment for him in the amount of $398,830.77 on July 5, 1972.

However, because Erma has no assets within the United States, and because satisfying the judgment in West Germany would involve great effort and expense, Poyner sought assets in the United States that could be applied to the judgment. Accordingly, on July 5, 1973, plaintiff filed a supplemental complaint against LSI, a Delaware corporation, to hold LSI liable for the judgment against Erma. LSI's relationship with Erma had been disclosed by L.A. in a third party complaint filed on December 21,

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capital they hold in the GmbH (quota share). Once the nominal capital is paid in, no further claims can be made against the shareholders -- uhless the creditors show facts which result in "piercing the corporate veil, or establish a manifest case of willful detriment (BGB §826). Although not identical, cases of "piercing the corporate veil" under German law are very similar to those under U.S. common law.

Id. at 1276-1277.



1971, seeking indemnification or contribution from LSI should L.A. be held liable on Poyner's original complaint.

The district court entered judgment on the supplemental complaint against LSI on May 1, 1975. It found that LSI, as sole shareholder, had the right according to West German law "to interfere at any time in the daily concerns of Erma." It found that the two members of Erma's aufsichstrat, or advisory board, were LSI personnel based in the United States, and that no formal meetings of that board were held, nor were records of meetings kept. It further found that LSI, exercising this control, had consciously adopted a "legal strategy" according to which Erma would not appear in this nor any other products liability action in the United States. The district court also found that LSI would then give "sub rosa assistance to other defendants. . . ."

The district court concluded that LSI had exercised its control of Erma to adopt a strategy designed to frustrate recovery for injuries, regardless of the merits of products liability claims, and had thereby worked "an unfair hardship on Erma's foreseeable American creditors." Therefore, the court decided that Erma's separate legal identity should be ignored and that LSI as its sole shareholder, should be held responsible for Erma's obligations.

Because it regarded Erma as "nothing more than a factory owned by LSI," and because LSI had controlled the litigation, the district court, applying the doctrines of collateral estoppel and res judicata, refused to permit LSI to open the judgment against Erma and to contest

the merits of plaintiff's case. Accordingly, it held that LSI was bound by the original judgment.

Three principal issues are presented in this appeal. The first, which Poyner contends that we cannot consider because LSI did not raise it timely, concerns the validity of the judgment against Erma. The resolution of this issue depends upon whether the Kentucky long-arm statute was applicable and properly followed, and whether its application to Erma is constitutionally permissible. The second is whether it was proper to pierce the corporate veil and thereby to hold LSI liable for Erma's obligation. The third is, if LSI should be held liable for Erma's obligations, whether the default judgment may be opened to permit LSI to contest the merits of the original action.

Because we hold that it was improper to disregard the separate corporate identities of Erma and LSI, it is unnecessary to decide the other two issues.

The question whether, in these circumstances, a corporation should be held liable for its corporate subsidiary's obligations that arise from the state law of products liability, is clearly a substantive issue governed by Kentucky law. See Erie Railroad Co. v. Tompkins, 304 U.S. 64 (1938).

The approach of the Kentucky courts to piercing the corporate veil has been described as evincing "a general aversion for any disregard of the corporate entity." Campbell, "Limited Liability for Corporate Shareholders: Myth or Matter-of-Fact," 63 Ky. L.J. 23, 48 (1975). Poyner argues that we should expand the



doctrine of Minton v. Cavaney, 56 Cal.2d 576, 15 Cal. Rptr. 641, 364 P.2d 473 (1961), which provides that the corporate veil should be pierced if a corporation is grossly undercapitalized, see 1 Fletcher, Cyclopedia of the Law of Private Corporations §44.1 (1974), and apply it to this case because LSI "has refused to risk any of its subsidiaries' assets in this country." But Poyner has cited no cases, and we have found none, in which the Kentucky courts have followed the growing trend of denying corporate entity treatment for inadequate capitalization, except in the event of faudulent reorganization. E.g., Harlan Pub. Svce. Co. v. Eastern Constr. Co., 254 Ky. 135, 71 S.W.2d 24, 29 (1934). We do not believe that the Kentucky courts would so extend a doctrine which they have not yet adopted in its basic formulation.

Ownership and control of a corporate entity by the persons sought to be held individually liable is necessary but not sufficient by itself for denial of entity treatment. Ky. Auto Mechanics Serv. Co. v. Ky. Auto Parts Co., 267 Ky. 531, 102 S.W.2d 1022 (1937)(one corporation owned the other's stock); C. L. & L. Motor Express Co. v. Achenbach, 259 Ky. 228, 82 S.W.2d 335 (1935)(two corporations had the same shareholders); id. at 340, citing Bergenthal v. State Garage and Trucking Co., 179 Wis. 42, 190 N.W. 901 (1922)(two corporations had same shareholders, officers and offices). Before a Kentucky court will disregard the corporate entity, it must also determine that the artificial personality serves to shield individuals from legal responsibility for fraudulent or criminal acts, or that the form of organization is subversive of public policy.[2]

[2]Although occasional dictum suggests that "subversice of public policy" is an independent

Big Four Mills v. Commercial Credit Co., 307 Ky. 612, 211 S.W.2d 831, 834 (1948). A corporation cannot "avoid . . . responsibility through the interposition of a mere legal fiction . . . ." Hermitage Land and Timber Co. v. Scott's Executrices, 263 Ky. 651, 93 S.W.2d 1, 3 (1936). The Kentucky courts will deny entity treatment only where "[t]he corporation was . . . organized to [or] has . . . in fact deprived [plaintiff] of any remedy he has . . . ." Lowry Watkins Mfg. Co. v. Bullington Mfg. Co., 248 Ky. 285, 58 S.W.2d 591, 593 (1933).

There emerges, then, a but-for test according to which the corporate entity is disregarded only where control of the fictive corporate

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ground in Kentucky for disregard of the corporate veil, only once has the Court of Appeals appeared to rely upon it alone. In Veterans Service Club v. Sweeney, 252 S.W.2d 25 (Ky. 1952), the court determined that the corporate form was being used "to sheild them from the consequences of these acts," but did not discuss the form of the arrangement and why it was regarded as no more than a fiction. The court mentioned only that one of the incorporators and officers was one of the managers of the club, and that the other two incorporators and officers had visited the club and seen gambling conducted there. The court appeared to regard these facts as relevant only insofar as they showed that these individuals knew of and sanctioned the gambling.

In Mordecai V. Ham Evangelistic Ass'n v. Matthews, 300 Ky. 402, 189 S.W.2d 524 (1945), the court emphasized the public policy of construing tax exemptions narrowly, but ultimately relied on the determination that the corporation was no more than Ham's alter ego.



person achieves a result which could not otherwise have been achieved directly. Lowry Watkins Mfg. Co., supra, at 592. Accordingly, LSI is liable if its ownership and control of Erma deprived Poyner of a remedy against Erma which he would have possessed but for LSI's control.

The district court found that LSI had exercised its control over Erma consciously to adopt the following "scheme": an injured American consumer would be forced either to bring suit in Germany to effect recovery against the manufacturer, or to "be faced with a double legal hurdle to get to LSI's assets in the United States." The prospect of being required to litigate in Germany or to prove both the products liability claim and the case for piercing the veil in a court in the United States "would be prohibitive." Therefore, the court "found" that the arrangement imposed an unfair hardship on Erma's foreseeable American creditors, and that the separate legal identities should be ignored.

If these determinations are actually "findings," our review is limited to the clearly erroneous standard. F.R. Civ. P. 52(a). However, the fact that a trial court labels determinations as "findings" does not make them so if they are in reality conclusions of law. In that case, they are subject to unrestricted review. Elyria-Journal Broadcasting Co. v. Lorain Journal Co., 298 F.2d 356 (6th Cir. 1961).

Whether it is appropriate to disregard the corporate entity, and whether Poyner would have to litigate both liability for the injuries and LSI's liability for Erma's obligations in order

to recover from LSI, are clearly questions of law. Whether an arrangment works an "unfair" hardship is similarly a question of law. If a determination concerns whether the evidence showed that something occurred or existed, it is a finding of fact. However, if a determination is made by processes of legal reasoning from, or of interpretation of the legal significance of, the evidentiary facts, it is a conclusion of law. Galena Oaks Corp. v. Scofield, 218 F.2d 217, 219 (5th Cir. 1954). See also Kippen v. Am. Automatic Typewriter Co., 324 F.2d 742, 745 (9th Cir. 1963)(whether there was "good cause" to discharge); Campbell Soup Co. v. Wentz, 172 F.2d 80 (3rd Cir. 1949)(whether carrots are "unique," permitting the remedy of specific performance). The issue whether a corporate arrangement works a hardship which is "unfair," and which therefore warrants denial of corporate entity treatment, is a question about the legal consequences which follow from the arrangement. It is therefore a conclusion of law.

The "unfairness" postulated by the district court is that the relationship of LSI to Erma relegated plaintiff to a choice between suing Erma in Germany and proving both liability of Erma for the injury and liability of LSI for Erma's obligations. However, unfair as this arrangement may have been, in order to meet Kentucky's strict but-for standard Poyner had to show that without LSI's exercise of control, plaintiff could have recovered from Erma. And Poyner has failed to demonstrate how LSI's control of Erma has made his recovery more difficult.

Relying upon American Ry. Express v. Commonwealth, 190 Ky. 636, 228 S.W. 433 (1920),



appellee argues that the arrangement between LSI and Erma is a fraudulent scheme to avoid subjecting Erma's assests to the jurisdiction of the Kentucky courts. The court pierced the corporate veil in that case to relieve the plaintiff of the necessity of pursuing the assets of the defendant in New York. Appellee urges that before the development of long-arm jurisdiction, the remedy of recovery from New York assets was as useless as pursuit of Erma's assets in Germany is today.

In American Ry. Express, supra, the Commonwealth of Kentucky had originally brought suit against the Adams Express Co., which operated in Kentucky. After judgment for the Commonwealth, execution was returned, "No property found." Before the suit began, Adams had transferred all its assets to American in return for stock in American. Adams remained in existence only for the purpose of winding up its affairs. All of Admas' assets (that is, the shares of American) were in New York, while its former assets in Kentucky belonged to American. The court reasoned that when all assets of one corporation are transferred to another corporation, so are the liabilities of the first corporation. The court held that the rule should be extended, for the better protection of creditors, to cover the case in which the first corporation retains some assets, but in effect removes them from the jurisdiction.

In the case at bar, however, Erma began its existence as a German manufacturing business. In 1962, American Metal Products Co. purchased all shares of Erma; in 1966, LSI acquired all assets of American Metal Products Co., including the stock of Erma and of another GmbH. Aside

from the merger of the two GmbH's, there is no suggestion that Erma's operations were altered in any material respect. Specifically, it is not suggested that before LSI's acquisition Erma appeared in actions against it in the United States, or subjected its assets to the jurisdiction of any American court, which, unlike the German courts, would of course be bound to accept the lawful decision of Kentucky courts under the Full Faith and Credit Clause.

Appellee's claim, therefore, must ultimately be that LSI's failure to change the status quo was sufficiently fraudulent to warrant disregard of the corporate identity of Erma. But in the fraudulent transfer situation, as in American Ry. Express, supra, on which appellee relies, the Kentucky Court of Appeals has ruled only that liability on a judgment may not be avoided by transfer of assets. E.g., Payne-Baber Coal Co. v. Butler, 276 Ky. 211, 123 S.W.2d 273 (1939). We do not believe, and appellee has cited no authority to persuade us, that the Kentucky courts would consider the failure to change the status quo to be a fraudulent avoidance of jurisdiction, because jurisdiction never existed in the first place.

The district court also determined that LSI should be held liable for Erma's obligation because it would be "unfair" to force Poyner to prove, inter alia, that this is an appropriate case for piercing the corporate veil in order to recover on the judgment against Erma. That argument is founded upon circular reasoning insofar as it relies upon the unfairness of having to make the case for denying separate entity treatment in order to establish the unfairness of having to prove just that.



So long as limited liability remains the rule, it is incumbent upon a plaintiff to demonstrate that the application of that rule to him is especially unfair, and indeed, according to Kentucky law, shields a fraudulent result. The LSI-Erma strategy of not appearing to contest products liability claims in the United States did not increase the burdens of recoving on such claims against Erma beyond those which existed before LSI's participation.

Appellee also relies upon Hermitage Land and Timber Co. v. Scott's Executrices, 263 Ky. 651, 93 S.W.2d 1 (1936), to show that this is the sort of situation which would lead Kentucky courts to deny separate entity treatment. In that case, two individuals were the only officers of both Hermitage and the Fibrecraft Chair Co. They were also virtually the sole shareholders of Fibercraft, which was in turn virtually the sole shareholder of Hermitage. Identifying themselves in the contract as officers of Hermitage, they signed a contract on Hermitage's behalf. They later sought to avoid Hermitage's obligation by relying upon a Kentucky statute which required written consent of the holders of two-thirds of a corporation's stock before the corporation might do certain acts. They argued that Fibrecraft's formal consent to Hermitage's contract was necessary, but absent. The court recognized "an attempt to avoid contractual responsibility through the interposition of a mere legal fiction . . . ." 93 S.W.2d at 3.

In this case, LSI, the sole shareholder of Erma, did not hold itself out as the authoritative party to a transaction, neither in the sale of this particular gun nor as a general matter. Nor did it attempt thereafter to avoid responsibility by interposing a fictive legal personality

over which it had control between itself and Poyner. To the contrary, Erma is "between" LSI and Poyner. LSI's relationship with Erma was apparently discovered only long after the injury to Poyner, and indeed only a few months before the motion for default judgment against Erma was filed. There was no reliance by Poyner upon LSI's responsibility.

We are not persuaded by appellee's argument that because the fraudulent result was condemned by the Kentucky courts in the cited cases, we should condemn the result in this case because it is in fact fraudulent. This argument is an oversimplification of the Kentucky rule, which requires the presence of particular legal elements before the corporate veil will be pierced. As our analysis shows, Poyner has not carried the burden of demonstrating that those elements are present.

This is the sort of appealing case which might have led the Kentucky courts to reexamine the doctrine of limited liability, or at least to further limit its application. However, we must apply the law as it appears in existing Kentucky decisions. We believe that it would be an unprecedented extension of the Kentucky doctrine to disregard Erma's separate corporate existence in this case. The judgment of the district court is therefore REVERSED and the case is remanded with instructions to vacate the judgment against appellant and to enter judgment in its favor.